

WALLER LANSDEN DORTCH & DAVIS, PLLC

WALLER LANSDEN DORTCH & DAVIS PLLC
THE CHESAPEAKE BUSINESS CENTRE
1616 WESTGATE CIRCLE SUITE 106
BRENTWOOD TENNESSEE 37027 8019
(615) 844-6212

WALLER LANSDEN DORTCH & DAVIS LLP
AFFILIATED WITH THE PROFESSIONAL LIMITED LIABILITY COMPANY
520 SOUTH GRAND AVENUE, SUITE 800
LOS ANGELES CALIFORNIA 90071
(213) 362 3680

NASHVILLE CITY CENTER
511 UNION STREET, SUITE 2700
POST OFFICE BOX 198966
NASHVILLE, TENNESSEE 37219-8966

(615) 244-6380
FAX (615) 244-6804
www.wallerlaw.com

WALLER LANSDEN DORTCH & DAVIS PLLC
809 SOUTH MAIN STREET
POST OFFICE BOX 1035
COLUMBIA, TENNESSEE 38402-1035
2005 MAY 11 11:40

TR.A. DOCKET ROOM

D. Billye Sanders
(615) 850-8951
billye.sanders@wallerlaw.com

May 4, 2005

VIA HAND DELIVERY

Pat Miller, Chairman
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, Tennessee 37219

Re: Petition of Chattanooga Gas Company for Approval of Adjustment
of its Rates and Charges and Revised Tariff
Docket No. 04-00034
Chattanooga Gas Company's Response to CAPD's Objections and
Motion to Strike and CAPD's Motion for Leave to Supplement the
Record

Dear Chairman Miller,

Enclosed you will find the original and thirteen copies of
Chattanooga Gas Company's Response to the Consumer Advocate and Protection
Division's Objections and Motion to Strike and the Consumer Advocate and
Protection Division's Motion for Leave to Supplement the Record.

Sincerely,



D. Billye Sanders
Attorney for Chattanooga Gas
Company

DBS/hmd

May 4, 2005

Page 2

cc: Archie Hickerson
Elizabeth Wade, Esq.
Steve Lindsey
Craig Dowdy, Esq.
Michael J. Morley
Parties of Record

BEFORE THE TENNESSEE REGULATORY AUTHORITY
NASHVILLE, TENNESSEE

IN RE:

PETITION OF CHATTANOOGA GAS
COMPANY FOR APPROVAL OF
ADJUSTMENT OF ITS RATE AND
CHARGES AND REVISED TARIFF

)
)
) DOCKET NO. 04-00034
)
)
)
)
)

**CHATTANOOGA GAS COMPANY'S RESPONSE TO CAPD'S
OBJECTIONS AND MOTION TO STRIKE AND
CAPD'S MOTION FOR LEAVE TO SUPPLEMENT THE RECORD**

Chattanooga Gas Company (CGC) hereby responds to the following pleadings filed by the Consumer Advocate Division of the Office of the Attorney General ("CAPD"): (1) the Consumer Advocate's Objections to and Motion to Strike Portions of Response Testimony of Michael J. Morley Regarding Recon-2 Filed April 6, 2005 ("Motion to Strike") and (2) the Motion for Leave to Supplement the Record ("Motion to Supplement"). For the reasons set forth below, CGC respectfully requests that the Tennessee Regulatory Authority ("TRA") overrule the CAPD's objections and deny the CAPD's above-stated motions.

I. CGC'S RESPONSE TO CAPD'S MOTION TO STRIKE

The CAPD's Motion to Strike is in essence a reply pleading to CGC's reply testimony which is beyond the procedural directives of the TRA and should be denied on that basis alone. Director Miller's motion, which was adopted by the TRA, established a procedural schedule in which CGC was to file any additional testimony or supporting documentation regarding Exhibit No. Recon-2 no later than March 14, 2005. The CAPD was allowed to file a written response and CGC was provided the opportunity to reply to the CAPD's response. Plainly, a reply by the

Consumer Advocate to CGC's reply would not be in keeping with the TRA's directives. Significantly, if one reads the CAPD's Motion to Strike, it becomes apparent that it is a thinly veiled attempt to reply to the merits of Mr. Morley's reply testimony. However, if the TRA does consider the CAPD's Motion to Strike, the same should still be denied for the following reasons:

A. CGC Witness Morley Was Correct In Stating That Dr. Brown's Supplemental Testimony Is Beyond The Scope Of Director Miller's Motion And The Issue Presented By CGC's Petition For Reconsideration Regarding The Determination Of The Appropriate Capital Structure Consistent With The Commission's Stated Methodology.

The CAPD takes issue with certain statements of the reply testimony of CGC witness Morley regarding Dr. Brown's failure to discuss the actual capital structure issue to which he was directed to respond by the TRA as setting forth legal opinions. The Consumer Advocate, in attempting to support its position quotes selectively from Mr. Morley's testimony. Mr. Morley's testimony as quoted more fully in relevant part is as follows:

"Dr. Brown's supplemental testimony does very little to discuss the capital structure issue to which he was to respond. The TRA has already determined the methodology for determining the appropriate capital structure. The CAPD did not seek reconsideration of the Authority's capital structure methodology and has lost the opportunity to do so. The purpose of Exhibit No. Recon-2 was to provide the necessary information to determine the capital structure based on the TRA's methodology. Part (1) of the motion issued February 28, 2005 by Tennessee Regulatory Authority ("TRA" or "Authority") Chairman Pat Miller and adopted by the TRA stated the following:

"Regarding the capital structure, I move that in order for the Authority to properly consider the new evidence on capital structure introduced into the record on December 31, 2004, Chattanooga Gas Company is ordered to provide additional testimony or supporting documentation regarding Exhibit No. Recon-2 no later than March 14, 2005. Such additional material should include all

assumptions used to derive the projected capital structure, explanation why equity and debt ratios drastically changed from December 31, 2003 to the subsequent reporting periods, and other relevant documentation.”

Thus, the sole issue to be addressed is AGL Resources Inc.’s (“AGLR”) capital structure as set forth in Exhibit No. Recon-2. Accordingly, the majority of Dr. Brown’s supplemental testimony is outside of the scope of both Director Miller’s motion and the only issue to be decided in CGC’s Petition for Reconsideration – the actual capital structure that is consistent with the stated methodology. Instead of responding to these issues, Dr. Brown constructs false claims and allegations that are not only irrelevant to the issue at hand but are also rash and misleading. Mr. McCormac provided exhibits to reflect a lower revenue requirement and lower resulting rate increase for CGC. These exhibits were based on an inappropriate and inaccurate capital structure and are not within the scope prescribed by this Authority in reconsidering the capital structure in this case. Again, the “alternative” capital structure recommended by the CAPD is not consistent with the TRA’s methodology.”

(Reply Testimony of Michael J. Morley filed April 6th 2005 (“Morley Supplemental Reply”), pp. 1-2). A review of the plain language of Director Miller’s motion and CGC’s Petition for Reconsideration in this proceeding confirm that Mr. Morley is correct in his assessment that Dr. Brown’s supplemental testimony is outside the scope of Director Miller’s motion and outside CGC’s request in its Petition for Reconsideration.

CGC made clear in its Petition for Reconsideration that the purpose of Exhibit No. Recon-2 was to ensure that there was record evidence upon which to base a capital structure determination consistent with the TRA’s chosen projected average capital structure methodology. CGC in its Petition for Reconsideration, stated the following:

In its Order, the TRA states that the capital structure is based on AGLR’s capital structure *and* is consistent with a prior CGC case, i.e., TRA Docket No. 97-00982 and other previous decisions of the Tennessee Public Service Commission (“TPSC”).

....

In CGC's last rate case, TRA Docket No. 97-00982, the TRA adopted a *projected* average capital structure of the parent for the attrition period. If the TRA uses the same methodology used in Docket No. 97-00982, which it stated it intended to do in this case, the resulting projected capital structure, ... would be:

Short term debt	4.07%
Long Term debt	40.24%
Preferred stock	9.47%
Common Equity	<u>46.22%</u>
Total Capitalization	100.00%

Consequently, this is the capital structure that is consistent with the panel's decision that CGC's cost of capital should be based on AGLR's capital structure and should be consistent with the methodology adopted by the Authority in CGC's last rate case in Docket No. 97-00982.

....

Because this methodology was not presented by any party to the proceeding, the data necessary to calculate the average capital structure for the attrition period is not in the record. Therefore, consistent with TRA §1220-1-2-.20, CGC seeks to present new evidence which would consist of the quarterly capital structures of AGLR during the attrition period and the resulting calculation of the projected average capital structure, a copy of which is provided as Exhibit No. Recon-2. In addition, CGC proposes to present Mr. Mike Morley as a witness to authenticate the exhibit. The lack of an opportunity to address this methodology during the proceeding provides a good cause basis for the introduction of new evidence on reconsideration.

Petition for Reconsideration, pp. 2, 4 and 11. Accordingly, CGC did not seek reconsideration of the Authority's capital structure methodology and the TRA's directive did not open

reconsideration to the presentation of other alternative capital structure methodologies.¹ Rather, the TRA directed the CAPD to respond to the merits of CGC's filed support for Exhibit No. Recon-2 as the basis for determining the projected average capital structure of AGLR. Instead of following this directive however, CAPD's responsive testimony drifts far afield and attempts to present a new alternative capital structure methodology for the Commission's consideration. Thus, Dr. Brown's testimony is beyond the scope of Director Miller's motion and the Authority's reconsideration of this matter. Mr. Morley's testimony in that regard is based on his reading and understanding of the plain language of Director Miller's motion and upon a reading of the above-quoted language from CGC's Petition for Reconsideration. Further, Mr. Morley has knowledge that CAPD failed to seek reconsideration of the TRA's Order in which it determined that the use of a projected average capital structure of AGLR is appropriate in this proceeding. It is common in proceedings such as this for regulatory witnesses to provide their understanding of regulatory directives because it is part of their everyday job responsibilities to comply or respond to such directives. Mr. Morley's job responsibilities require an understanding of regulatory directives and procedures from many state regulatory jurisdictions as well as the FERC and the SEC. The TRA is not bound by the strict rules of evidence and can give Mr. Morley's testimony whatever probative weight it deems appropriate. See TCA 4-5-313(1). The CAPD's Motion to Strike these portions of Mr. Morley's testimony should be denied.

CAPD's Motion to Strike also alleges that Mr. Morley has shown personal animosity and engaged in personal attacks toward Dr. Brown. Motion to Strike, pp. 5-6. CAPD's allegations

¹ CAPD asserts in its Motion to Strike that CGC has expressed some doubt as to the capital structure methodology utilized by the TRA in its order. In an attempt to support its claim, CAPD selectively quotes from the oral argument on the Petition for Reconsideration. Motion to Strike, p. 4. However, a full reading of the oral argument demonstrates that the only confusion in the Order stems from the use of a CAPD exhibit to calculate the projected average capital structure for AGLR. Transcript, pp. 121-122. The Authority's selected methodology is clear.

are without merit. It is important to note that Mr. Morley's testimony is reply testimony to that of Dr. Brown. The record is clear in this proceeding that it is Dr. Brown who has engaged in attacks on Mr. Morley and on AGLR's ethics and integrity. As much as possible, Mr. Morley in his reply has focused on addressing Dr. Brown's attacks, false claims, and allegations as opposed to addressing Dr. Brown personally. For example, as noted in the Morley testimony:

Dr. Brown once again accuses AGLR of applying inconsistent capital structures to its other utility subsidiaries and calls into question the integrity and ethics of AGLR. Dr. Brown's unwarranted allegations are irresponsible and without basis. Dr. Brown's continued attacks on AGLR's integrity are unprofessional and demonstrates a lack of understanding of basic ratemaking principles and practices. His testimony also displays a lack of knowledge with respect to the reporting requirements of AGLR as prescribed by state regulatory agencies and the Securities and Exchange Commission ("SEC").

Morley Supplemental Reply, p. 3 (emphasis added). Mr. Morley's testimony takes issue with Dr. Brown's unwarranted allegations, continued attacks, and tries to avoid personal attacks. The last sentence of the above-quoted testimony goes to Dr. Brown's qualifications and is not, as alleged, a personal attack. Accordingly, Mr. Morley's testimony is not improper and the CAPD's Motion to Strike should be denied.

B. CGC Witness Morley In His Testimony Properly Responded To Dr. Brown's Allegations And Incorrect Factual Assertions And Has Not Attempted To Update Exhibit No. Recon-2 With New Evidence.

CAPD in its Motion to Strike alleges that the testimony of Mr. Morley attempts to introduce new evidence into the proceeding. Motion to Strike, p. 6. The CAPD goes on to maintain that "the record in this case is now closed." *Id.* Importantly, CGC has not attempted to revise or update Exhibit No. Recon-2 even though doing so would favor CGC's position in this proceeding. However, CAPD cannot be allowed to introduce testimony beyond the record and raise issues which have occurred after the close of the record while attempting to hold CGC

only to the record in its response. Rather, CGC is entitled to respond to such allegations and Mr. Morley does so in his testimony. For example, CAPD takes issue with Mr. Morley referencing that the financing of NUI did not have an impact on the capital structure of AGLR and the fact that the bridge facility was terminated. These statements were in direct response to Dr. Brown questioning the affects of AGLR's financing of its NUI purchase. Supplemental Testimony of Stephen N. Brown filed March 20, 2005, pp. 19, 24, 25. The NUI acquisition occurred after the close of the record in this proceeding. Dr. Brown improperly attempts to use his allegations for the incorrect assertion that AGLR's short-term debt ratio should increase from what is shown on Exhibit No. Recon-2. Mr. Morley's testimony appropriately points out Dr. Brown's error and rebuts his assertions.

As well, Mr. Morley's testimony and exhibits regarding the authorized capital structures of AGLR's regulated entities is in direct rebuttal of Dr. Brown's incorrect assertion that AGLR applies different capital structures arbitrarily to different regulated entities. At no point does Mr. Morley state that the information he provides in rebuttal supports or revises the Company's projected capital structure in this reconsideration as shown on Exhibit No. Recon-2. In rebuttal to Dr. Brown's assertion, the Morley information merely shows that AGLR applies the capital structure which is authorized by the appropriate state jurisdiction for the respective entities and does not arbitrarily apply capital structure as Dr. Brown alleges. Accordingly, CAPD's Motion to Strike the testimony of Mr. Morley that directly rebuts Dr. Brown's incorrect assertions should be denied.

C. Mr. Morley's Rebuttal Testimony and Conclusions Have a Sufficient Foundation to Support Their Probative Value.

CAPD in its Motion to Strike also provides five statements that it alleges are unsupported allegations and conclusions and should be stricken from the record. Motion to Strike, pp. 8-9.

CAPD's Motion in this regard borders on a frivolous pleading and should be denied. The specific statements and CGC's response are as follows:

1. In response to Dr. Brown's unique belief that only verified financial information can be used in a regulatory proceeding, Mr. Morley stated that "regulatory agencies generally use unaudited information more than they use audited financial information." Morley Supplemental Reply, p. 11. Mr. Morley's statement is based on his extensive financial and regulatory experience involving multiple jurisdictions in which AGLR entities are involved in regulatory proceedings and have an ongoing reporting requirement. In his experience, the majority of information requested and used by regulatory jurisdictions is unaudited information. This is also a fact so commonly known by regulatory commission staff and people with extensive regulatory experience that it demonstrates how extreme many of CAPD's assertions are.

2. In response to Dr. Brown's comments that Mr. Morley's capital structure projections missed the mark by a "country mile," Mr. Morley stated that "most objective accountants and financial analysts would agree that a 5% variance [in a forecast] is reasonable and would view my projected capital structures as credible." Morley Supplemental Reply, p. 17. Here again, Mr. Morley's statements are based on his extensive financial and regulatory experience. In the context of the entire average projected capital structure, when compared to actuals and given all of the assumptions that go into a capital structure forecast, CGC continues to believe that most objective accountants and financial analysts would agree. Further, CGC believes that most objective accountants and financial analysts would agree that a 5% variance is not missing the mark by "a country mile."

3. In response to Dr. Brown's claim that CGC is plainly wrong in its opinion that utilization of a single point of December 31 of any year gives an inaccurate view of the capital structure of a gas utility, Mr. Morley asserted among other things that Dr. Brown's use of financial information for the single point in time "contradicts basic ratemaking principles and procedures." Morley Supplemental Reply, p. 13. Mr. Morley's statement that Dr. Brown advocates a single point in time refers to Dr. Brown's unique requirement that only audited financial information be used by a regulatory agency and that 10-Qs are not reliable which necessarily means only end of year audited information should be used. Use of an end of year number for a gas utility overstates the short-term debt portion of the capital structure based on gas inventories being at their highest at the beginning of winter season. Mr. Morley's statement regarding appropriate ratemaking principles refers to the traditional notion that in ratemaking, ones tries to estimate as close as possible the actual financial condition the utility will experience during an attrition period.² Plainly, taking only an end of year view of capital structure as opposed to averaging the quarterly results would not meet this basic ratemaking principle.

4. Again, in response to Dr. Brown's unique assertion that only audited information should be relied upon, Mr. Morley states that "the basis for most of [Dr. Brown's] arguments in his direct case and supplemental testimony also is unaudited information..." Morley Supplemental Reply, p. 11. CAPD in its Motion claims that the statement is unsupported. Significantly, Mr. Morley at p. 12 of his testimony provides three specific examples which include:

² *South Central Bell Telephone v Tennessee Public Service Commission*, 579 S W 2d 429 (TN Ct App 1979) In this case the Tennessee Court of Appeals stated that " the test period results must be adjusted to take into account known changes that are likely to occur in the immediate future To ignore these expenses and changes reasonably certain to occur fails to follow the basic purpose of rate making, to set rates for the future" (at p 6)

- Dr. Brown relies on AGLR's September 30, 2004 Form 10-Q (pgs 24-25) to incorrectly assert that AGLR will most likely utilize more short-term debt to finance the acquisition of NUI.
- Dr. Brown relies on an application with the Virginia State Corporation Commission ("VSCC") for authority for VNG to issue short-term debt and long-term debt as his basis for his proposed "alternative" capital structure. Dr. Brown also used this same filing from 2003 in his direct testimony to support his inaccurate position that AGLR arbitrarily applies capital structures to its utility subsidiaries.
- Dr. Brown relies on unaudited capital structure information included in the SEC's order authorizing the acquisition of NUI to wrongly claim that AGLR will apply a 16.9% short-term debt ratio to NUI.

Accordingly, Mr. Morley has supported his statement.

5. In response to CAPD's allegation that AGLR has not reported correctly a rate increase, Mr. Morley stated that "a revenue increase is not the same thing as a rate increase." His statement is accurate. A revenue increase is the result of a rate increase. However, rate increases can result in an impact to more items than just revenues. An example, is the TRA's decision to recover bad debt expenses through the PGA. This resulted in a decrease to expense, not an increase to revenues. For example, CGC has had two rate increases in 2005 – one that impacted revenues and one that impacted O&M expense. Mr. Morley explains this position in his testimony. Morley Supplemental Reply, p. 25.

II. CAPD'S MOTION TO SUPPLEMENT SHOULD BE DENIED.

After arguing in its Motion to Strike that the record is closed, CAPD then filed a Motion to Supplement in an attempt to add confidential information filed with the SEC in this proceeding. CGC agrees with CAPD's original position that the record in this matter is closed and should not be reopened. If supplemental information is to be allowed, then CGC will move for the admission of subsequent financial data including its upcoming 10-Q which supports its

position on capital structure in this matter. Moreover, the information CAPD seeks to add to the record is not relevant because it does not represent the actual capital structures of AGLR's various regulated entities as stand alone entities. In determining capital structure during a rate proceeding for subsidiary companies a relevant determination is the proxy capital structure for the entity as if it were a stand alone company. That is why authorized capital structures of each entity is the relevant comparison. Since each entity is part of a consolidated holding company, most long-term debt, preferred equity and common equity are issued by AGLR or its financing subsidiaries, not the regulated entities. This consolidation of debt and equity provides for lower cost of capital throughout the organization. In addition, the consolidated capital structure is the per books capital structure of AGLR and does not include the pro-forma adjustment to exclude the impact of Other Comprehensive Income ("OCI") on common equity. Mr. Morley clearly delineated this issue in his testimony and supporting exhibits. Accordingly, the addition of CAPD's late filed requested information is not relevant to the Authority's determination of the appropriate capital structure for CGC and CAPD's Motion to Supplement should be denied.

III. CONCLUSION

For the foregoing reasons, CGC respectfully requests that the TRA deny CAPD's Motion to Strike and Motion to Supplement.

Respectfully Submitted,

Chattanooga Gas Company

By: D. Billye Sanders

D. Billye Sanders, Esq.

Waller Lansden Dortch & Davis

A Professional Limited Liability Company

511 Union Street, Suite 2700

Nashville, TN 37219-8966

(615) 244-6380

Attorney for Chattanooga Gas Company

CERTIFICATE OF SERVICE

I hereby certify that on this 4th day of May, 2005, a true and correct copy of the foregoing document was delivered by hand delivery or U.S. mail postage prepaid to the other Counsel of Record listed below.

D. Billye Sanders
D. Billye Sanders, Esq.

Vance Broemel
Assistant Attorney General
Tim Phillips
Assistant Attorney General
Office of Attorney General
Consumer Advocate and Protection Division
2nd Floor
425 5th Avenue North
Nashville, TN 37243-0491
Timothy.Phillips@state.tn.us
Vance.Broemel@state.tn.us

Mailing address:
P.O. Box 20207
Nashville, TN 37202

David C. Higney, Esq.
Grant, Konvalinka & Harrison, P.C.
633 Chestnut Street, 9th Floor
Chattanooga, TN 37450-0900
423-756-8400 (phone)
423-756-0643 (fax)
dchigney@gkhpc.com

Henry M. Walker, Esq.
Boult Cummings, Conners & Berry, PLC
414 Union Street, Ste 1600
Nashville, TN 37219
615-244-2582 (phone)
615-252-6380 (fax)
hwalker@boultcummings.com

Dale Grimes, Esq.
Bass, Berry & Sims PLC
AmSouth Center
Suite 2700
315 Deaderick Street
Nashville, TN 37238
dgrimes@bassberry.com